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Economic Freedom of the World: 2007 Annual Report

Petar Ganev

“The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete, and security of private property!”

The Fraser Institute, Canada

Hong Kong once again tops international rankings for economic freedom, with Singapore a close second and New Zealand in third spot, according to **the *Economic Freedom of the World: 2007 Annual Report***, published by The Fraser Institute. Zimbabwe and Myanmar had the lowest economic freedom ratings of the 141 countries measured.

Bulgaria improved its position since last year with 9 places and its ranked 56 with the highest rating of economic freedom ever, 6.9 out of 10. Bulgaria shares this position with countries like Poland, Greece and Uruguay.

Economic Freedom of the World, measures the degree to which the policies and institutions of countries are supportive of economic freedom. The annual peer-reviewed report uses 42 different measures to create an index ranking countries around the world based on policies that encourage economic freedom. Research shows that individuals living in countries with high

levels of economic freedom enjoy higher levels of prosperity, greater individual freedoms, and longer life spans.

This year's publication ranks 141 nations for 2005, the most recent year for which data are available. The report also updates data in earlier reports in instances where data have been revised.

International Rankings

In this year's main index, Hong Kong retains the highest rating for economic freedom, 8.9 out of 10. The other top scorers are: Singapore (8.8), New Zealand (8.5), Switzerland (8.3), Canada (8.1), United Kingdom (8.1), United States (8.1), Estonia (8.0), Australia (7.9), and Ireland (7.9).

The rankings and scores of other large economies are Germany, 18 (7.6); Japan, 22 (7.5); Mexico, 44 (7.1); France, 52 (7.0); Italy, 52 (7.0); India, 69 (6.6); China, 86 (6.3); Brazil, 101 (6.0); and Russia, 112 (5.8).

The majority of nations ranked near the bottom are African and all the nations in the bottom 10 are African, with the exceptions of Venezuela and Myanmar. They are: Zimbabwe (2.9), Myanmar (3.8), the Democratic Republic of the Congo, (4.0), Angola (4.2), the Republic of the Congo, (4.3), Central Africa Republic, (4.6), Venezuela (4.9), Burundi (5.0), Chad (5.1), Togo (5.1) and Niger (5.1). Botswana's ranking, tied for 38th with a score of 7.2, is the best among sub-Saharan African nations.

“Weakness in the rule of law and property rights is particularly pronounced in sub-Saharan Africa, in many parts of the Middle East, and for several nations that were part of the former Soviet bloc although some of these nations have shown improvement,” said James Gwartney, lead author of the report and a Professor of Economics at Florida State University.

“Many Latin American and Southeast Asian nations also score poorly for rule of law and property rights. The nations that rank poorly in this category also tend to score poorly in the trade and regulation categories, even though several have reasonably sized governments and sound money.”

This year 11 additional countries have been added to the index. These countries are Angola (4.2, 138th), Bosnia and Herzegovina (6.1, 97th), Burkina Faso (5.5, 122nd), Ethiopia (6.0, 101st), Kazakhstan (7.3, 32nd), Kyrgyz Republic (6.8, 60th), Lesotho (6.8, 60th), Mauritania (6.5, 76th), Moldova (6.5, 76th), Montenegro (6.8, 60th), and Serbia (5.6, 119th).

Global Spread of Economic Freedom

The 2007 edition of the Economic Freedom of the World report also includes new research from Russell Sobel, economics professor at West Virginia University, and Peter Leeson, professor in the study of capitalism at George Mason University, showing how economic freedom spreads between countries.

Sobel and Leeson note that historically, many foreign policy decisions have been based on the notion that economic reforms in a few key nations would substantially improve the economies of other countries throughout the region – the so-called “domino effect.”

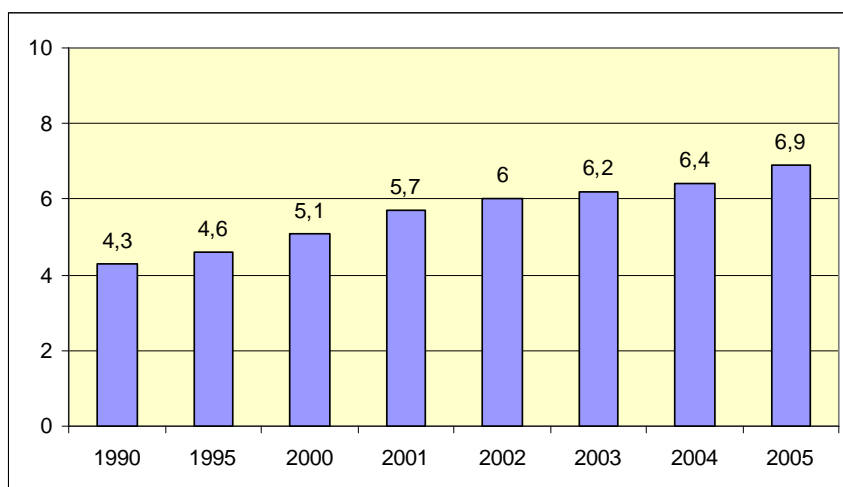
The authors conclude that while economic freedom changes in one country have only a modest impact on neighbouring countries, when multiple neighbours experience simultaneous changes in economic freedom, the impact is much greater. Broad regional changes in freedom can and do have significant impacts on surrounding countries. By liberalizing trade with foreign nations, economically free countries can exert a positive, if modest, impact on economic freedom in less free nations.

This research indicates that free-trade agreements allowing a number of nations to simultaneously coordinate trade liberalization could have a sizeable influence on spreading economic freedom to economically repressed regions of the world, Sobel and Leeson said.

Economic Freedom in Bulgaria

During the last 15 years the economic freedom in Bulgaria is continuously improving, starting from score of 4.3 in 1990 and reaching 6.9 in 2005. This year score is higher than the previous one (2004) with 0.5 points. That means that Bulgarian performance is improving even faster than before.

Scores of Bulgaria 1990 – 2005



Source: Economic Freedom of the World: 2007 Annual Report

Bulgaria scores in key components of economic freedom (from 1 to 10 where a higher value indicates a higher level of economic freedom):

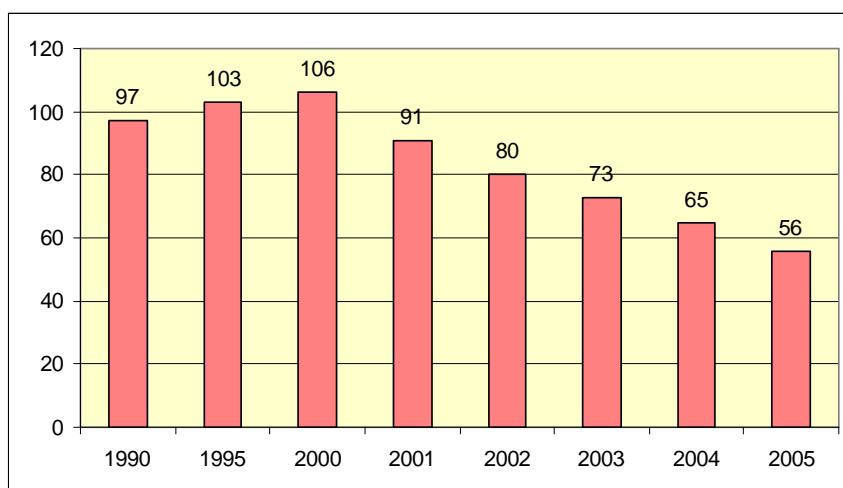
- **Size of government:** 5.8 (5.0 in 2004);
- **Legal structures and security of property rights:** 5.7 (4.6 in 2004);
- **Access to sound money:** 8.9 (8.7 in 2004);
- **Freedom to trade internationally:** 7.2 (7.3 in 2004);
- **Regulation of credit, labour and business:** 6.7 (6.2 in 2004).

This improvement of Bulgarian score is mainly because of the performance in the first two key components. **Size of government**, measures the government interference in the economic life, is

rather better than the previous years. In 2005, Bulgarian government cut both personal income tax and corporate income tax. Continued privatization influenced this key component too, as BTC – Bulgarian Telecommunications Company was privatized in 2005. **Legal structures and security of property rights** is doing better mainly because of the better **protection of property rights** and measures of the new subcomponent **regulatory restrictions on sale of real property**.

The highest score of Bulgaria through the years is making strong impact on the Bulgarian place in the international ranking of economic freedom. Bulgaria is ranked 56th from 141 nations, while last years it was ranked 67th. Since 2000, Bulgaria improved its position with 50 places, from 106th to 56th.

Rankings of Bulgaria 1990 – 2005



Source: Economic Freedom of the World: 2007 Annual Report

This year's annual report shows that the economic freedom is still spreading in Bulgaria. This process is giving the people more opportunities to prosper and live better. We should continue to follow this path of development and key reforms like already announced introduction of flat tax from 2008 are vital for the economic freedom in Bulgaria.

The annual report is published in conjunction with the Economic Freedom Network, a group of independent research and educational institutes in over 70 nations.

For more information on the Economic Freedom Network, data sets, and previous Economic Freedom of the World reports, visit www.freetheworld.com

GDP in the Second Quarter Of 2007

Dimitar Chobanov

National Statistical Institute officially released preliminary national accounts data for the second quarter and the first half of 2007. Gross domestic product (GDP) keeps growing by more than 6 percent on annual basis which is good news.

Factors determining this positive development are related to expanding of the economic freedom in the country during the last few years. An indicator for this is the last report of Fraser Institute, which poses Bulgaria 9 places higher than the last year ranking. The key aspects of economic liberty are the voluntary exchange, free entry to markets, inviolability of private property, limited government, and sound money. These elements lead, in longer term, to high average income in the country, higher economic growth, more investment, low rate of corruption, higher life expectancy and lower child mortality rates.

Reforms in taxation during the last years are substantial for the economic growth. Lower rates on direct taxes offset higher excise duties, imposed to comply with the European Union legislation. Still, lower rates on corporate income tax (10% from the beginning of 2007), on personal income tax and on social insurance contributions create incentives to people to work more, as they keep larger share of generated income. On the other hand, the tax base is wider because costs for evasion are lower.

The effect of these policies could be found in higher formal employment which is a evident in terms of new jobs created as well as declaring incomes for taxation that are closer to the actual amounts. The result is higher budget revenues over the planned and larger budget surplus though the spending is also higher. Hence, in 2007 tax rates could be lowered to larger extent (particularly taxation of labor) without posing any threat to the fiscal soundness.

Unfortunately, reforms of the other determinants of the economic freedom are slow or do not happen at all lately. Property rights are not well

protected; government purposefully or not interferes on specific markets thus protecting the monopoly power of certain companies and ultimately prevents the competition instead of promoting it. The result is not optimal allocation of resources and lower growth rate than the potential.

Data show that GDP increases in real terms by 6.6% for the second quarter and by 6.4% for the first half of the year. Gross value added grows by 8.7% and 8.2% respectively which is the highest rate since 1998. The contribution of industrial sector (real growth rate for the half-year of 9.1%) and of services (8.8%), while agricultural sector is in slump again (production falls by 2.3%). This development is a consequence of investment and capital accumulation in these sectors, while in agriculture this process is too slow. Moreover, even the expected EU subsidies do not lead to positive results. Still, current state could be explained by unfavorable climate conditions in 2007 though the main problem is insufficient investment leading to low efficiency, bad crops and limited opportunities for making profits.

Final consumption slightly decreases as a share of GDP growing by 6% in real terms for the first half of the year. The contribution of investment to the GDP growth is the largest, as they rise by 29.6%. Their growth rate in real terms is slowing down in the second quarter (24.7%) relative to the first one (35.9%). This process will probably continue which will lead to deceleration of GDP growth.

National account data are not surprising as a whole. The slight acceleration of the real GDP growth could be characterizes as good news but it is probably a temporary. It is important to specify whether it is a sustainable process and are there policies that could boost the long-term potential of the economy. Reforms of the public sector would have such effect and particularly the education, healthcare, internal and external security and for public administration spending. Apart from this measures directed to liberalization of specific industries, decrease in regulatory burden and barriers to entry and exit of businesses would have a positive impact on the economy. In fact, this is and maybe the straight way to faster economic growth and higher incomes for Bulgarians.

It's the Rules that Matter

Svetla Kostadinova

The current Bulgarian government released its biannual report. It gives us the opportunity to clearly define the principles and approaches used during the ruling. These are:

- 1) Many problems are solved by **spending more money** – despite the statements made in 2005 for reducing of state expenditures it is obvious that they don't decrease but on contrary. However, government spending distorts market incentives which in turn reflect inflation, prices and wages. We should bear in mind that these are our money but decisions on spending are taken by clerks with questionable knowledge and interests.
- 2) **No assessment is made** of how government decisions will affect citizens and business. By assessment we mean expenditures imposed by certain regulation and whether benefits will exceed costs. This means that (1) the government cannot count and therefore doesn't do it; (2) it doesn't want to do it because is countless and want to support specific groups in the society or (3) it knows that the calculations will show lack of any economic logic. Whatever the reason, it is clear that the government should be accountable about any expenditure and policy because it spends our money.
- 3) **If something good can be postponed it for sure is delayed** – the excuse is often lack of money, administrative capacity or time. The truth is that many of the reasonable delayed reforms do not need any of these – reduction of social security contributions to 10% or finalizing of privatization does not require such resources. There are, of course, reforms that require some financing but even when such is secured there is delay in time, i.e. trade register reform. We don't even mention such fundamental reforms as healthcare, education and pension system that lack official long-term vision of what should be done.
- 4) **Some of the good ideas** that succeed to edge into government's agenda are almost always accompanied by other reforms that neutralize the positive effect or minimize it. An example is the idea of introducing 10% flat income tax that is coupled with increase of maximum insurance threshold and excises.
- 5) The bold, radical and effective reforms **are insufficient** – reduction of corporate tax and social security contributions, introduction of maximum period for recipients of social welfare benefits, etc. are just not enough for significant improvement of living standards and business environment.
- 6) **Transparency** is still not a requirement – giving information especially regarding administration' work and decision-making process is still not a rule. This hampers planning, complying and working with administration.
- 7) **Overspending of administration** – the report shows that some ministries can easily be shrunk by half without hampering overall work.

In addition, we can say that there are no indicated causes for unsuccessful implementation of some of the government programs in the report.

Last, but not least, there is no calculation how much does it cost to all taxpayers government decisions/policy. Good results are fine, but it is also important how much resources are used and how. Unfortunately, hardly anyone from the government knows exactly the "price" because there is no cost-benefit analysis of regulations in Bulgaria still.

Each politician knows that if he wants to be remembered he should do something radical and at the beginning of his mandate so the results appear until its end and be enough for reelection. Current government made so far something positive – reduction of corporate tax to 10%. Several good reforms have been started but it questionable whether there will be political will to be finalized because of the increased pressure for more money from groups in the society. The question is does the government assess the situation realistically and what it will do. The report does not say anything on this.

New Programs of the Social Ministry – from Employment to Qualification

Adriana Mladenova

This week the social minister Mrs Maslarova declared a provisional change in the direction of the policy of the Ministry of Labour and Social Policy of Bulgaria on the labour market. The current programs that pay to employers and companies to hire unemployed will be replaced by new ones that aim to pay for courses of qualification and prequalification of the unemployed. This change is due to the situation we have experienced during the last several months of decreasing unemployment rates under 8%, and at the same time, lack of qualified workers in many spheres of the economy such as constriction, textile and hotel industries.

According to the report describing the two-year anniversary of the government, during the period of August 2005 - July 2007 240 thousand new job positions have been opened in the country. This success, however, is due not to the employment programs of the Social Ministry, but mainly to creating prerequisites in the economy for more business opportunities and development of the private sector.

Minister Maslarova said that 10 thousand new job positions have been opened with state subsidies for the reported period. In 2006 138 thousand people have been included in the employment programs and 47 thousand people have been involved in training organized by the Social Ministry that cost 100 mln. Euro to the taxpayers. For the first six months of 2007 100 thousand people have been included in the employment and training programs which in monetary terms amounts to 34 mln. Euro. Beside these aggregate data, however, we can not find information and analysis how many of the trained have been permanently employed after the training courses and what have been the long-term impacts on people after the end of the social programs.

At the same time, in 2006 and at the beginning of 2007 there are many other factors that have played a positive role on the labour market. Social security contributions were decreased by

6 percentage points and the harmonization of the labour legislation in the country with that of the EU lead to liberalization and greater flexibility on the labour market. These are the drivers of increased employment rates and less unemployment in the country.

Therefore, the following questions should be answered before a decision is taken for every new proposed program in the Social Ministry:

- § How much will these programs cost – taking into account not only the direct expenses for financing and implementation of the programs, but also, for administrative capacity building and enforcing of the project ideas?
- § What will be the benefits and will they outweigh the costs?
- § What are the opportunity costs of all these expenses? Less expenses for social programs in theory means more disposable income for taxpayers or financing of other public programs. That is what the program budgeting is all about – competition among various projects and realization of those that bring the highest net benefit for the society.
- § Can a right decision be taken by government officials and centralized bodies what skills and abilities need those that seek work?

The answers to all these basic questions should be provided with detailed and strong arguments in their favour. At the heart of each decision of individuals lies private motivation and interest. The state cannot train and qualify somebody if he is not motivated enough or has no incentives for that. Therefore, in order to achieve its aim, the government should seek for market solutions such as introduction of education vouchers; decreasing of social security contributions and taxes, which means more financial resources at disposal of employers for qualification and training of their staff; liberalization of the process of hiring of workers from abroad by Bulgarian companies, which will serve as a stimulus for better qualification and enhancing the labour productivity of the Bulgarians.

“New Deal for Bulgaria”

Veliko Dimitrov

In the course of the week (19.09.07), at an organized press conference, the relatively new political party CEDB (Citizens for European Development of Bulgaria)¹ revealed its complete economic program – the vision how Bulgaria is to be governed if the party wins enough seats at the next parliamentary elections. Since the very foundation of the party, more or less acquainted with the topic groups has been arguing if it is left, right or with whatever other affiliations party. I will attempt to answer this question only assessing the economic program².

Division in politics between left and right is made on the basis of the understanding of liberty that each party has. There are two types of liberty in general (some interrelation between the two is always present) – individual and economic liberty. More individual freedom means more liberal understanding upon questions like abortions, people with non-traditional sexual orientation, immigration, light drugs, prostitution, etc. Usually these standpoints are presented by left-oriented politicians and parties. More economic freedom means less government intervention in the economic life of people in general – as consumers, producers, investors, etc. This in turn means less regulations, lower taxes, less state-owned enterprises, less subsidies and bureaucracy. This view is usually shared by right-oriented politicians and political parties.

Measuring these two freedoms on one scale is obviously impossible and to a certain extent unnecessary. Conventional division of left and right may be presented also well if we take just the attitude toward economic liberty because first, exactly these policies always attract attention and second, because they have the greatest weight in determining future economic development.

Which are the main ideas of CEDB?

- Lower government expenditures – reducing the redistribution through the

budget to 30% of GDP (now it is around 40% varying slightly if measured using revenues or expenditures);

- Introduction of a high (in the case of Bulgarian average income) non-taxable income level of 1 000 levs (1 lev = 0,5 euro) and a lower VAT rate of 15% (currently 20%);
- Abolishment of the heritage and donations taxes;
- Widening and deepening of the fiscal decentralization – municipalities shall rely to a lower degree on the central budget and on the decisions of the central government;
- Repayment of state debt;
- School autonomy, voucher system and major shift of the barrier toward the end of the educational period – instead of having accession exams, those would take place before graduation;
- Autonomy of universities and change in the way how they are financed – no more direct state subsidies;
- Equal treatment of state and private health funds – they have to compete;
- Reduction of the mandatory pension contribution from 23% to 10%; the whole payment goes to a private pension fund chosen by everyone;
- Less government regulations in terms of licensing; introduction of the principle of “silence consent”;
- Less power for the sector regulators; abrogation of all delegated in the past rights to organizations outside the state for the introduction of compulsory membership, fees, quasi-licensing, etc.

The listed above measures as well as many others included in the economic program of the new party guarantee more economic freedom. In this sense, at least at this stage, the political party CEDB could and should not be deemed as other than right.

I hope that these good ideas will be put in practice. Then the newly established party will prove that it is right in practical terms as well.

¹ GERB in Bulgarian – **Grazdani za Evropejsko Razvitie na Bulgaria**

² Accessible at: http://gerb-bg.com/Gerb_Program_logo.doc (only Bulgarian)

Health Care System in Singapore

Metodi V. Metodiev

In the next few paragraphs I'm going to describe the health care system in Singapore and especially how it works. This approach seeks to mainstream the better practices that are already being applied in some countries. Because sometimes is easier, more effective and painless just to copy some good and working ideas.

So how does Singapore achieve such impressive results? The Singapore health system is based on a combination of government subsidies (through taxation) and individual responsibility. In order to assist individuals in meeting their component of personal medical expenses, the Government has established the framework of Medisave, Medishield and Medifund that combine individual responsibility and is overlaid with government funding, particularly to provide a safety net to support the health needs of low income earners and poorer individuals.

The key to Singapore's efficient health care system is the emphasis on the individual to assume responsibility towards their own health and, importantly, their own health expenditure. The result is a system that is predominantly funded by private rather than public expenditure.

1. Medifund

Medifund is an endowment fund set up by the Singapore Government to assist those in financial hardship in funding their medical needs. The scheme is intended as a safety net for those who cannot afford the subsidized charges for hospital or specialist out-patient treatment, after allowing for any Medisave or Medishield funds. Qualification for Medifund provision is means tested, based on an individual's financial circumstances at the time of application.

2. Medisave

Medisave is a compulsory medical savings scheme with funds available to meet a portion of future personal or immediate family's hospitalization, day surgery and certain outpatient expenses.

Medisave is a subset of the mandatory Government pension scheme (the Central

Provident Fund or CPF) to which a total of 33 per cent of wages is contributed (comprising 13 per cent employer contributions and 20 per cent employee contributions) to individual accounts to fund retirement and health related expenditure. Of the 33 per cent contribution, around 6 per cent to 8 per cent (depending on age) is credited to the employee's Medisave account. In practice, Medisave covers approximately 85 per cent of Singapore's population.

3. Medishield

Medishield is effectively a national insurance scheme for catastrophic illness that is intended to cover a significant component of medical expenses from major or prolonged illnesses that are not covered by Medisave. Medishield operates under a scheduled reimbursement system based on days of hospitalization and type of surgical treatment, offset by individuals sharing costs by way of co-payments and deductibles.

The Government has, in recent years, allowed the private insurance market to offer similar Medishield-type policies so individuals now have a choice of choosing between Medishield or a private alternative. Premiums for Medishield (or private insurance alternatives) can be paid from an individual's Medisave account.

4. Eldershield

The Government has also recently introduced Eldershield, an extension to the '3M' system. Eldershield is a private insurance scheme designed to help fund future medical expenses incurred in the event of severe disability, particularly at advanced ages.

Conclusion

The key to Singapore's efficient health care system is in its emphasis on the **individual** to make a significant contribution towards their own healthcare costs. With this focus, the Government has been able to maintain a relatively low level of public expenditure (below 1%) on health for many years with the major burden put on individuals and/or their employers.

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